

**THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION NO. 2006-171**

ISSUE: Is an attorney who has withdrawn a fee from a client trust account in compliance with rule 4-100(A)(2), ethically obligated to return any of the withdrawn funds to the client trust account when the client later disputes the fee?

DIGEST: Once an attorney has withdrawn a fee from a client trust account in compliance with rule 4-100(A)(2), those funds cease to have trust account status. As such, there is no obligation to return to the trust account amounts that are later disputed by the client.

AUTHORITIES

INTERPRETED: Rule 4-100 of the Rules of Professional Conduct of the State Bar of California

STATEMENT OF FACTS

Attorney represents Client in a litigation matter that Client has brought against Adversary. A written fee agreement between Attorney and Client states that Attorney will be paid a contingent fee equal to a percentage of Client's "net recovery" in the matter, if any. Consistent with the State Bar's Sample Written Fee Agreement Form for a contingency fee agreement, Client's "net recovery" is defined as the total of all amounts received by settlement or judgment less certain scheduled costs and disbursements. Under the terms of the fee agreement, Attorney is entitled to 25% of Client's net recovery if the matter is resolved prior to the filing of a lawsuit, and one-third (33 1/3 %) of Client's net recovery if the matter is resolved at any time thereafter. The agreement complies with California Business and Professions Code section 6147 in all respects, and includes a valid charging lien, and statesing that Attorney is entitled to take his fee from the Client's recovery, whether by judgment, award or settlement.

The case settles after the filing of the lawsuit but before the commencement of trial. Client executes and delivers a settlement agreement with Adversary pursuant to which Adversary agrees to pay Client \$100,000. Upon execution and delivery of the settlement agreement, Adversary sends Attorney a check for \$100,000 payable jointly to Attorney and Client. As required by rule 4-100(B)(1), Rules of Professional Conduct of the State Bar of California,^{1/} Attorney notifies the Client of receipt of the funds, and pursuant to rule 4-100(B)(3) Attorney provides Client a written accounting setting forth the following proposed distribution:

1. Total settlement amount of \$100,000;
2. Itemized list of costs and disbursements in the aggregate amount of \$7,000;
3. Amount to be paid to Attorney as his fee - one-third of the net recovery of \$93,000 or \$31,000; and
4. Net amount to be paid to Client - the remaining balance of \$62,000.

Client comes to Attorney's office, goes over the accounting with Attorney, endorses the settlement check and signs off on the accounting approving the proposed distribution. As required by rule 4-100(A), Attorney deposits the \$100,000 settlement check in Attorney's Client Trust Account ("CTA"). Promptly upon confirming that the \$100,000 check has cleared, and reasonably believing the representation concluded and the fee "fixed" within the meaning of rule 4-100(A)(2), Attorney writes two checks out of the CTA as follows: a check to Client in the amount of \$62,000 and a check payable to Attorney's general account in the amount of \$38,000 as reimbursement of

^{1/} All rule references are to the Rules of Professional Conduct of the State Bar of California.

\$7,000 in costs and payment of \$31,000 in fees. Pursuant to Client's instructions, Attorney immediately mails the \$62,000 check to Client. Attorney also immediately deposits the \$38,000 check into Attorney's general account. A week later, Attorney receives a telephone call from Client who tells Attorney that the \$31,000 fee is too high for the amount of work actually performed and that Attorney should send Client a check for an additional \$10,000.

DISCUSSION

Trust Account Status

Rule 4-100(A) states that "[a]ll funds received or held for the benefit of clients by a member or law firm, including advances for costs and expenses, shall be deposited in one or more identifiable bank accounts labeled "Trust Account," "Client's Funds Account" or words of similar import" Money that an attorney holds "for the benefit of clients" includes:

1. Money that belongs to a client;
2. Money in which the attorney and client have a joint interest;
3. Money in which a client and a third party have a joint interest; and
4. Money that doesn't belong to a client, but which counsel is nevertheless holding as part of the subject representation.^{2/}

Such funds ("trust account funds," or funds having "trust account status") are subject to various requirements regarding disbursement, payment of interest, record keeping and the like as set forth in rule 4-100 and authorities interpreting it. Principal among these restrictions is a flat prohibition on the commingling of trust account funds and an attorney's personal or office funds. In fact, regarding withdrawal of trust account funds for payment of fees, rule 4-100(A)(2) states that any portion of trust account funds that belong to counsel "must be withdrawn at the earliest reasonable time after [his or her] interest in that portion becomes fixed," unless the attorney's portion is disputed by the client for any reason. In such event, rule 4-100(A)(2) further instructs that "the disputed portion shall not be withdrawn until the dispute is finally resolved."

However, rule 4-100 is silent regarding the situation where a fee properly withdrawn from a CTA is later disputed. In that regard, we believe that the inquiry is whether funds properly withdrawn from a CTA under rule 4-100(A)(2) and later disputed by the client retain or regain its trust account status once the dispute is communicated to the attorney. Based on a plain reading of the rule we answer this question in the negative. Attorney, in the situation presented, neither "received" nor "holds" the withdrawn funds for the benefit of the client. Quite the contrary, at the moment of withdrawal, the withdrawn funds are Attorney's personal property by operation of rule 4-100(A)(2). As such, Attorney is both obligated to withdraw the funds from the CTA and free to do with those funds as she or he pleases. At the moment of withdrawal, none of the indicia of trust account status are present: the withdrawn funds do not belong to the client, are not subject to a joint interest of attorney and client, are not subject to a joint interest of the client and any third party, and are not being held by the Attorney as part of the subject representation.

Likewise, the fact that Attorney has withdrawn the fee from a CTA (as opposed to having received it by way of the client's personal check or by accepting cash from the client) is analytically irrelevant. There is no authority in the text of rule 4-100 or elsewhere to suggest that funds with trust account status, properly "fixed" and withdrawn under rule 4-100(A)(2), regain trust account status simply because the client later disputes the fee. Such a conclusion would also create a host of problems for the practical administration of a law office, if, for example, the withdrawn

^{2/} The State Bar of California, *Handbook on Client Trust Accounting for California Attorneys* (2003) at pg. 13. [*Publisher's Note:* Information that appears on page 13 of the *Handbook on Client Trust Accounting for California Attorneys* (2003), now appears on page 15 of the *Handbook on Client Trust Accounting for California Attorneys* (2011).]

funds were used to pay staff salaries or bona fide office expenses, or, if the withdrawal happens in one tax year while the client's challenge occurs in the next.

As such, absent trust account status, the withdrawn funds are analytically equivalent to money paid by client to Attorney for charged fees by any other means. The fact that the client later expresses remorse, regret or other dissatisfaction with the amount of Attorney's fee is a matter of contract to be resolved by an analysis of the engagement agreement and the respective performance of the parties.

Misappropriation Distinguished

It is worth repeating that the Statement of Facts presupposes a proper withdrawal of the fee. We are mindful of the substantial authority relating to the misappropriation of trust account funds.^{3/} In that regard, we note simply that funds misappropriated from a CTA, or withdrawn before an attorney's fee becomes "fixed" within the scope of rule 4-100(B)(2), are funds in which the client has a whole or part ownership interest.^{4/} As such, misappropriated funds are ones that have never lost their trust account status and remain subject to rule 4-100 in all respects.

CONCLUSION

Funds properly withdrawn from a CTA under rule 4-100(A)(2) and later disputed by the client neither retain nor regain their trust account status, and therefore do not need to be re-deposited into the attorney's CTA. Based on a plain reading of rule 4-100, we believe that such funds bear none of the indicia of trust account status at the moment of withdrawal, i.e., the withdrawn funds do not belong to the client, are not subject to a joint interest of attorney and client, are not subject to a joint interest of the client and any third party, and are not being held by the Attorney as part of the subject representation. As such, absent trust account status, the withdrawn funds are analytically equivalent to money paid by Client to Attorney for charged fees by any other means. The fact that Client later expresses remorse, regret or other dissatisfaction with the amount of Attorney's fee is a matter of contract to be resolved by an analysis of the engagement agreement and the respective performance of the parties.

This opinion is issued by the Standing Committee on Professional Responsibility and Conduct of the State Bar of California. It is advisory only. It is not binding upon the courts, the State Bar of California, its Board of Governors, any persons, or tribunals charged with regulatory responsibilities, or any member of the State Bar.

^{3/} See, e.g., *Sternlieb v. State Bar* (1990) 52 Cal.3d 317, 328 [276 Cal.Rptr. 346]; *Bates v. State Bar* (1990) 51 Cal.3d 1056 [275 Cal.Rptr. 381]; *Walker v. State Bar* (1989) 49 Cal.3d 1107 [264 Cal.Rptr. 825]; and *Garlow v. State Bar* (1988) 44 Cal.3d 689 [244 Cal.Rptr. 452]; (failure to restore misappropriated funds warrants discipline).

^{4/} Misappropriation of client trust funds may occur without an intent to commit a conversion of client funds. (See: *McKnight v. State Bar* (1991) 53 Cal.3d 1025 [281 Cal. Rptr. 766]; *Giovanazzi v. State Bar* (1980) 28 Cal.3d 465 [169 Cal. Rptr. 581]; *In the Matter of Doran* (Rev. Dept. 1998) 3 Cal. State Bar Ct. Rptr. 871; and *In the Matter of Bleecker* (Rev. Dept. 1990) 1 Cal. State Bar Ct. Rptr. 113.) Readers are cautioned that a lawyer has been disciplined for failing to hold funds in a CTA where a withdrawal of funds was based upon a belief that the disbursement was proper, at the time of the disbursement, but that belief was subsequently discovered to be erroneous. (See *In the Matter of Respondent E* (Rev. Dept. 1991) 1 Cal. State Bar Ct. Rptr. 716.)